



# Trends in material weaknesses for non-IPO companies

KPMG 2022 Study

# About this study

## 2022 material weakness study (non-IPO companies)

### Purpose

The purpose of this study was to identify the common themes and business process areas associated with material weaknesses (MW) reported by public companies. The statistics that follow stem from a study performed by KPMG in the summer of 2022.



### Approach

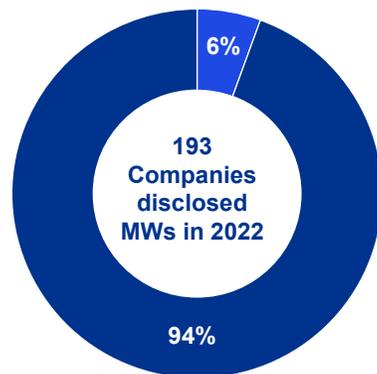
The study analyzed annual filings released by SEC-registered public companies between July 2017 and June 2022. Data was reviewed from the third-party research database Audit Analytics, and all MWs reported were aggregated and then summarized based on the underlying themes and affected business processes related to the MW.

For purposes of this report, the 2022 year considers MWs reported in any public company filing that was released between July 2021 and June 2022. The MWs reported in this year's study came from companies with year-ends through April 30, 2022. KPMG notes that the data set underlying this study does not include IPO companies that were first time filers during the time period of the report.



# 2018-2022 material weaknesses study – background statistics

## Comparison of MW percentages over the last five years of the study

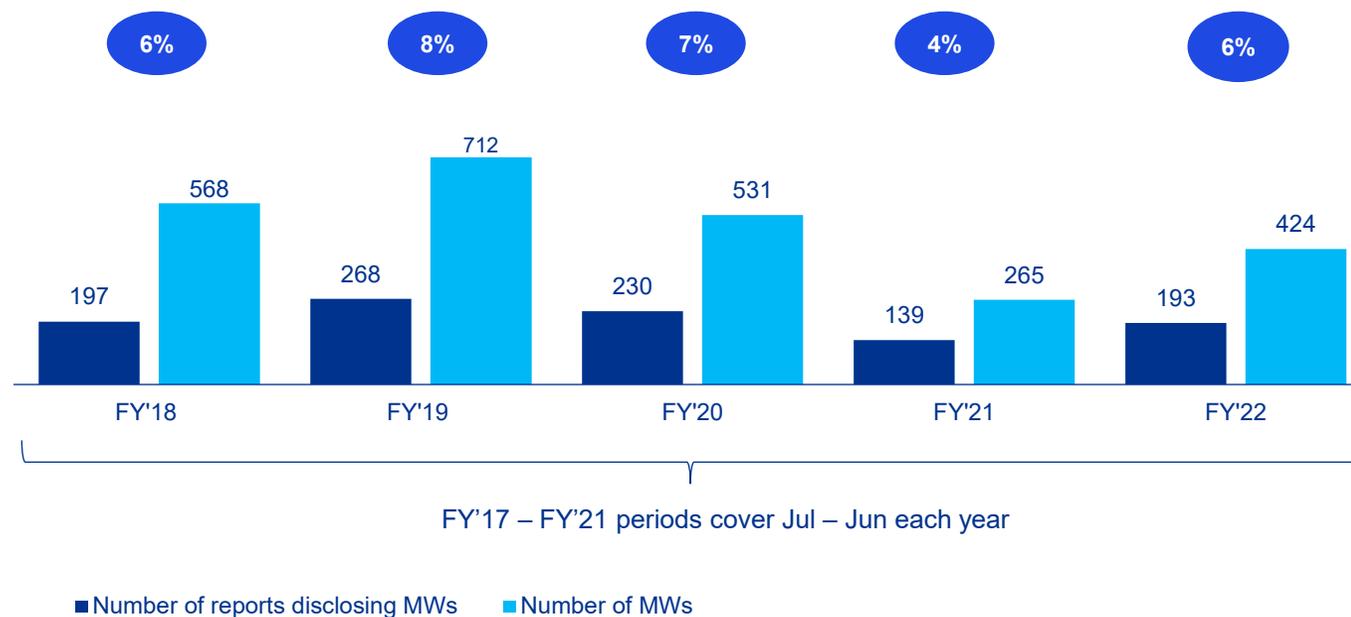


Of the **3,366 annual reports** filed in 2021, **193 companies (6%)** disclosed MWs in their filings as of June 30.

As of June 2022, the unique number of companies filing reports with MWs for 2022 continues to be slightly lower than pre-2020 levels due to the SEC's amended accelerated filer definition effective April 2020. However, the percentage of companies disclosing MWs in 2022 (6%) was consistent with pre-pandemic levels.

### Percent of companies disclosing MWs, by year<sup>^</sup>

The % of MWs is consistently in the 6% - 8% range during years covered by the study with a decline in FY'20

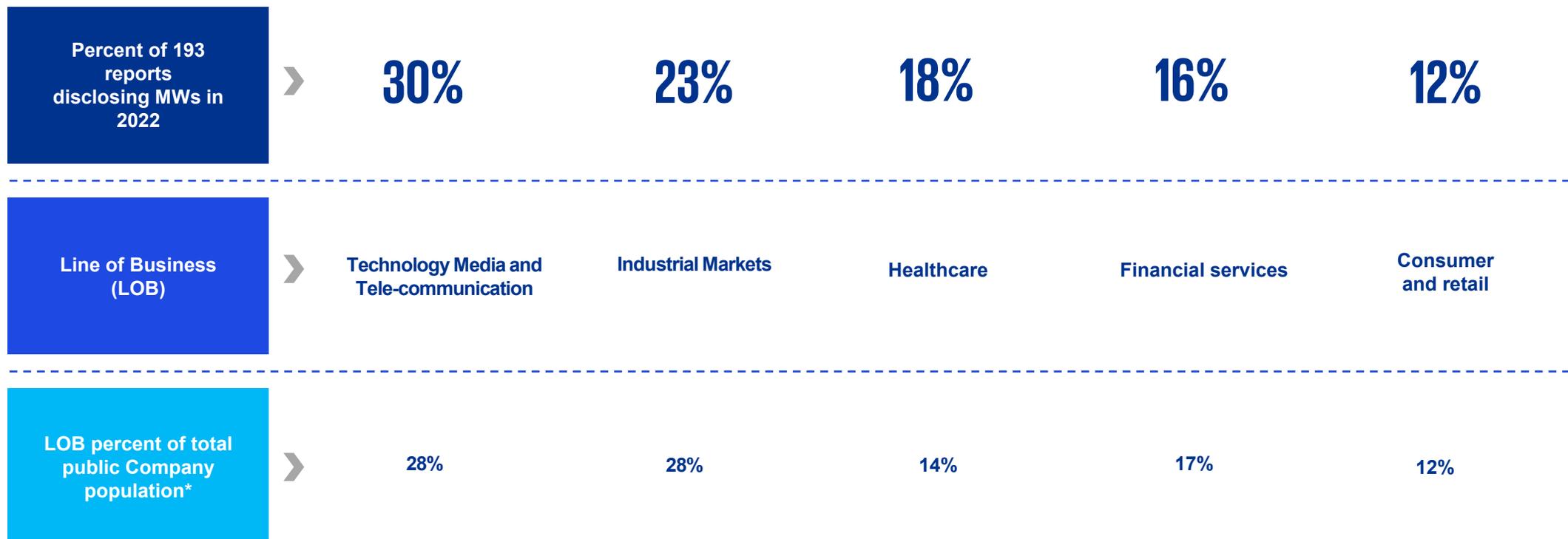


<sup>^</sup> % represents # of companies that disclosed material weaknesses over the total number of filings

# 2022 material weaknesses study – background statistics

## Industry breakdown of companies that disclosed MWs in their filings in the year 2022

As a percentage of MWs reported compared to the size of the industry sector, Healthcare shows the highest incidence of MWs.



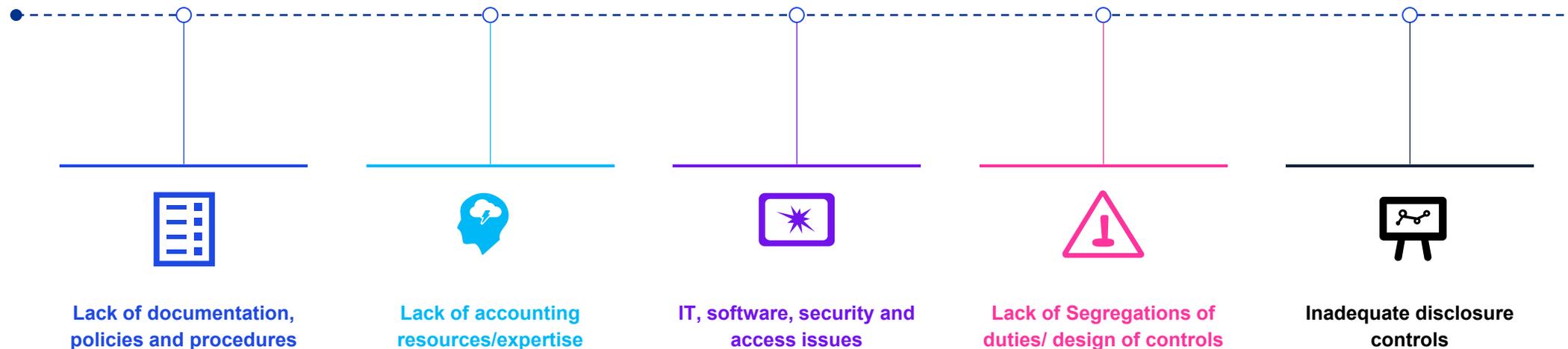
\* % Calculations based on 1,027 reports with MWs between 2018-2022

# Summary of material weakness themes reported

## Issues contributing to MWs in 2022

Apart from the top five primary themes of material weaknesses noted below, 8% of companies have reported issues related to *restatement of company filings*.

### The five primary themes for 2022 MW root causes

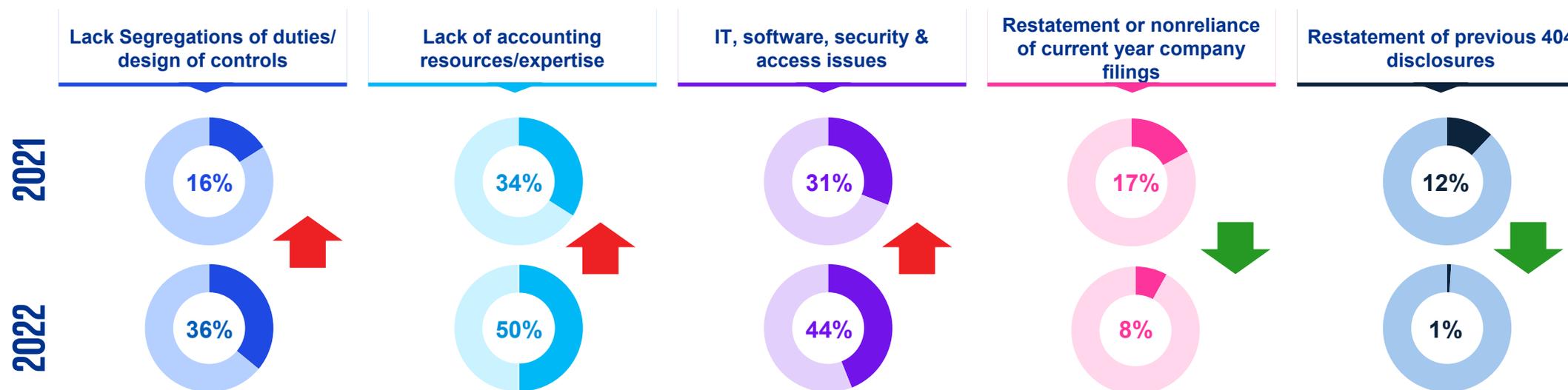


Note: Key themes are defined as those which applied to 20% or more of companies reporting MWs.

# Trends in material weakness themes reported

## Notable changes between FY'22 and FY'21 trends in MWs

MWs related to lack of segregation of duties, lack of accounting resources/expertise, and IT, software, security & access issues all showed significant increases in 2022, following decreases in each area in the 2021 SOX year. All of these issues were primary themes in 2022. MWs related to restatement of 404 disclosures and/or company filings significantly declined in 2022 and were not primary MW themes.

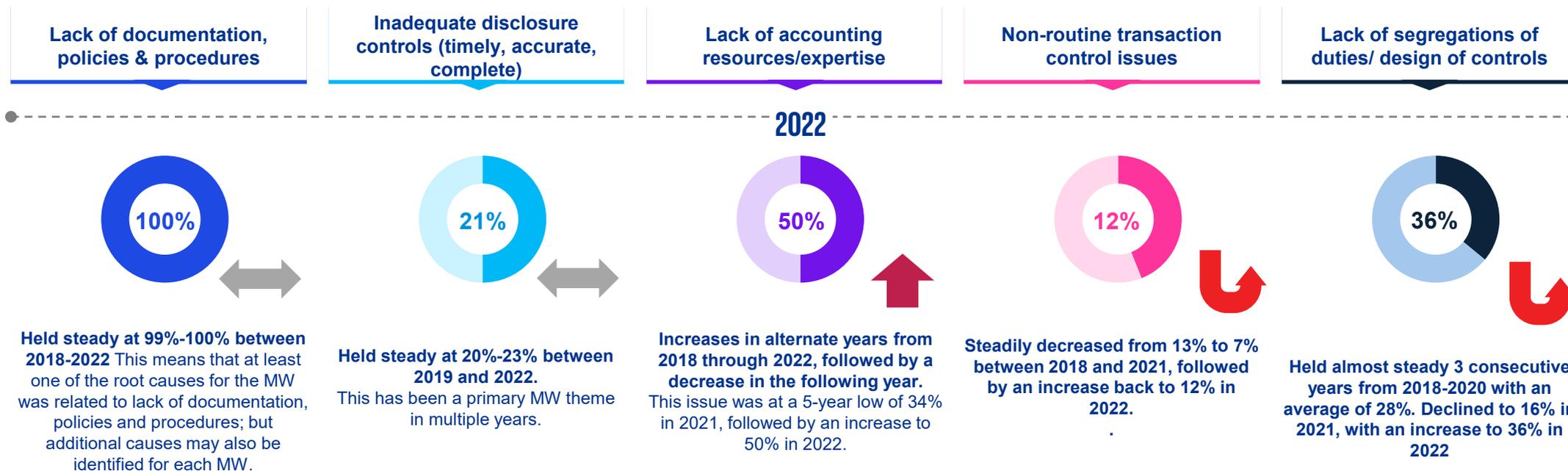


- Material weaknesses reported were often the result of more than one overlapping issue/challenge
- Percentages are calculated by dividing the number of companies with material weaknesses in a category by total number of reports in the stated year. Individual companies may be reported in multiple years.

# Trends in material weakness themes reported (continued)

## Notable trends in issues contributing to MWs over the last 5 years

The following issues contributing to MWs showed notable trends over the last several years, as depicted below.



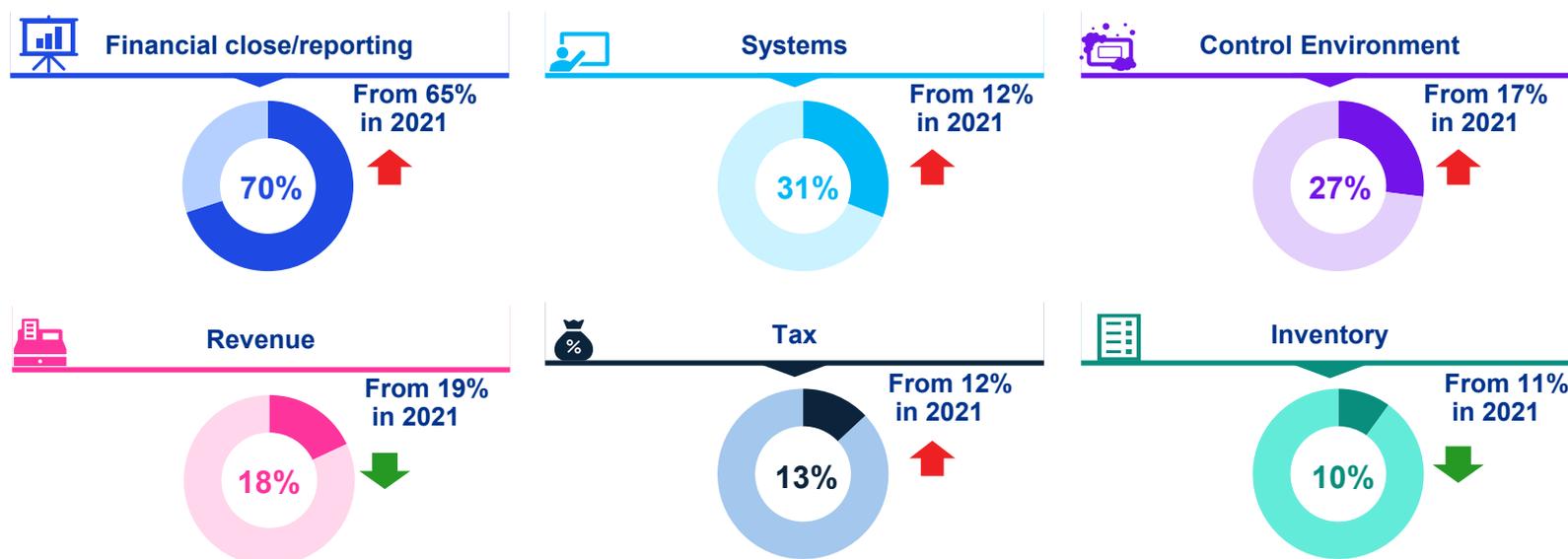
- Material weaknesses reported were often the result of more than one overlapping issue/challenge
- Percentages are calculated by dividing the number of companies with material weaknesses in a category by total number of reports between 2018-2022 (1,027). Individual companies may be reported in multiple years.

# Trends in material weakness process areas

## Process areas with highest concentration of MWs in 2022

The following issues contributing to MWs showed notable changes between 2021 and 2022 filings, as depicted below.

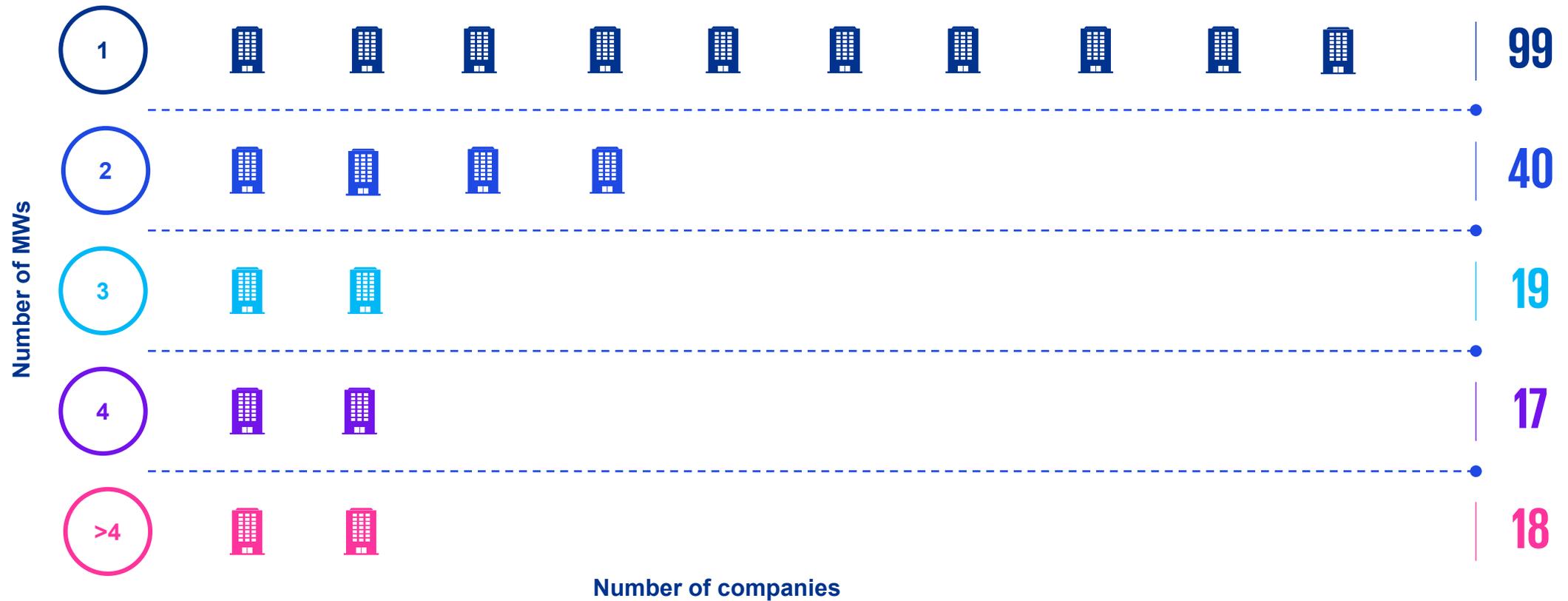
Financial Close/reporting and Systems were added as top process areas in 2022, while equity was removed as a top process area as compared to 2021. The graphs below represent the percentage by process area reported in 2022, with notable percentage changes indicated next to the relevant process area.



- Material weaknesses reported often impacted multiple process areas
- Percentages are calculated by dividing the number of companies with material weaknesses in a category by total number of companies that reported MWs (193) for 2022.

# Summary of material weaknesses reported in 2022

Number of companies by total material weaknesses disclosed

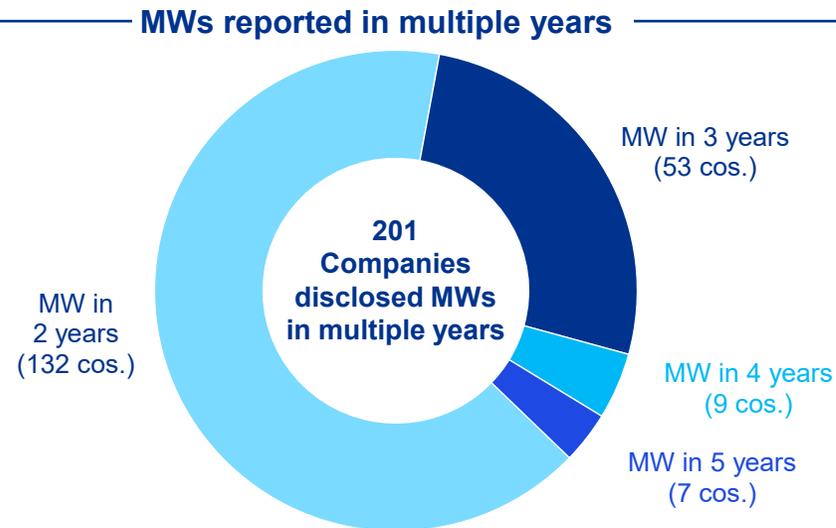


# Material weaknesses in multiple years

## Trends in MWs over multiple years

Between 2018–2022\*, there were 201 companies that reported MWs in multiple years, which represents 28% of the total companies filing a report during the time period.

Of the 709<sup>^</sup> companies that filed a report between 2018-2022, 201 companies (28%) disclosed MWs in multiple years



\* This analysis is based on the data sets included in our current and previous studies, dating back to KPMG's 2018 Material Weakness study.

<sup>^</sup> The 709 companies reported in the table above represent the unique count of companies filing a report with a MW between 2018-2022 (i.e. excluding duplicative company counts in which there was a multiple MW reported or multiple filings in one year).

# Examples of material weaknesses

## Common themes in 2022



### Lack of documentation, policies and procedures

“...control deficiencies, in internal controls over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected on a timely basis ...”



### Lack of accounting resources/expertise

“Management has identified that the Company did not employ sufficient accounting resources with appropriate experience and technical expertise to effectively execute controls over certain judgmental and technical accounting areas....”



### IT, software, security and access issues

“...identified deficiencies in control over certain information technology (IT) general controls for revenue-related systems that are relevant to the preparation of our financial statements...”



### Segregations of duties/ design of controls

“.. deficiencies identified in our controls over user access which did not adequately restrict or provision/deprovision user access related to certain financial reporting programs and did not ensure appropriate segregation of duties as it relates to review ...”



### Inadequate disclosure controls

“... Ineffective process-level controls associated with the revenue, purchasing and inventory, treasury, property and equipment, tax, and payroll processes that (a) addressed relevant risks ...”

Source: Audit Analytics MW data through June 2022

# Examples of material weaknesses

## Top three process areas in 2022



### Financial close/reporting

“...We did not adequately design and implement controls that address the relevant financial statement assertions over the Financial Statement Close and Reporting Process...”



### Systems

“...material weakness is related to ineffective information technology general controls (“ITGCs”) in the areas of user access and segregation of duties related to certain information technology (“IT”) systems that support the Company’s financial reporting process....”



### Control Environment

“... an ineffective control environment which (i) did not ensure that senior personnel in the Company’s accounting function engaged consistently in appropriate professional conduct and conduct consistent with the Company’s Code of Business Conduct and Ethics...”

Source: Audit Analytics MW data through June 2022



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